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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

December 31, 2005

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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

December 31, 2005

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APPOINTIVE OFFICIALS

George Parisot, Lottery Director

John Tarr, Lottery Assistant Director for Security

LOTTERY COMMISSION		TERM EXPIRES
Tom Keegan	Helena	January 1, 2006
Betty Wilkins	Missoula	January 1, 2006
Robert Crippen	Butte	January 1, 2007
Wilbur Rehmann	Helena	January 1, 2009
Craig Anderson	Glendive	January 1, 2009

According to Section 23-7-202(9), MCA, copies of this report must be distributed to the following:

Governor – Brian Schweitzer
Director of Dept. of Administration – Janet Kelly
Legislative Auditor - Scott Seacat
President of the Senate – Jon Tester
Speaker of the House – Gary Matthews

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature". The President of the Senate and the Speaker of the House have requested that this report be distributed to the following committees:

HOUSE – State Administration Committee

Larry Jent, Chair
Dee Brown, Vice Chair Majority
Veronica Small-Eastman, Vice Chair Minority
Joan Andersen
Mary Caferro
Sue Dickenson
Emelie Eaton
Robin Hamilton
Gordon Hendrick
Teresa Henry
Hal Jacobson
William Jones
Gary MacLaren
Bruce Malcolm
Alan Olson
Bernie Olson

HOUSE – Business & Labor Committee

Jim Keane, Chair
Kathleen Galvin-Halcro, Vice Chair Majority
Joe McKenney, Vice Chair Minority
Elsie Arntzen
Bob Bergren
Tim Dowell
Kevin Furey
Dave Gallik
Ralph Heinert
Llew Jones
Mike Jopek
Harry Klock
Scott Mendenhall
Mike Milburn
Don Roberts
Wayne Stahl
Dan Villa
Jonathan Windy Boy

SENATE – State Administration Committee

Carolyn Squires, Chair
Joe Balyeat
Vicki Cocchiarella
Mike Cooney
Jon Ellingson
Jeff Essmann
Steve Gallus
Rick Laible
Dave Lewis
Jim Shockley
Joe Tropila

SENATE – Business & Labor Committee

Vicki Cocchiarella, Chair
Joe Balyeat
Duane Grimes
Dave Lewis
Glenn Roush
Frank Smith
Carolyn Squires
Donald Steinbeisser
Bill Tash
Jon Tester
Joe Tropila

Montana Lottery

March 2006

Montana Lottery Commission:

The Lottery will transfer $2,586,944 to the General Fund as a result of operations in the second quarter of fiscal year 2006 compared to $1,792,596 for the same time period last year. Total transfer to date will be $3,901,572 compared to $3,257,068 last year, a 19.8% increase. The results of this quarter's operations compensate for a slow first quarter and put the Lottery at 48.9% of its projected transfer for the year.

Scratch sales continue to be strong with a sales increase of 13.1% compared to the same time period last year. Powerball experienced its largest jackpot ever and sales were 22.7% higher. Montana Cash had a 19.9% increase, Wild Card sales were steady and Hot Lotto and Qwik Tix sales were both down. The Montana Cash average jackpot for the period was slightly higher than last year, Wild Card's slightly lower, while Hot Lotto's jackpots are substantially less this year than last. Overall sales were up 15%.

Direct game costs were consistent with sales for the quarter and the fiscal year. Net operating revenue as a percent of total revenue is 31.7% for the second quarter of fiscal 2006 and 30.6% for the year to date. Total operating expenses of $1,010,079 for the quarter and $2,134,970 year to date are higher than last year's by 8.8%; however, total budgeted expenses are 50.61% of budget for the year.

The Lottery currently is emphasizing the Power Play option through some of its advertising. Prior to October, Power Play averaged only 5% of Powerball sales; we are now averaging 10%. If this trend continues, it is expected to produce approximately $1 million of additional revenue per year.

The conversion to Intralot, as our gaming system vendor, continues. We are currently on target or ahead of schedule in all areas. Communication satellites have been installed at retailer locations. Retailer training began on February 20 and is scheduled for completion on March 15. All aspects of the conversion are progressing satisfactorily.

Sincerely,

George Parisot
Director

2525 North Montana Avenue • Helena, MT 59601-0598
Phone 406-444-LUCK (5825) • Fax 406-444-5830

MONTANA LOTTERY
STATEMENT OF NET ASSETS
DECEMBER 30, 2005 and 2004
(UNAUDITED)

	Period Ended December 31, 2005	Period Ended December 31, 2004
ASSETS:		
CURRENT ASSETS		
Cash and Cash Equivalents	$ 2,800,001	$ 225,042
Receivables (Net)	1,330,362	1,374,350
Inventories	823,272	832,556
Other Current Assets	17,200	18,905
TOTAL CURRENT ASSETS	4,970,835	2,450,853
NONCURRENT ASSETS		
Computer, Furniture & Equipment	5,570,754	5,550,957
Accumulated Depreciation	(5,273,625)	(4,371,366)
Software, net of Amortization	41,071	205,357
Multi-State Receivable	1,320,079	1,276,231
TOTAL NONCURRENT ASSETS	1,658,279	2,661,179
TOTAL ASSETS	$ 6,629,114	$ 5,112,032
LIABILITIES:		
CURRENT LIABILITIES		
Accounts Payable	$ 439,826	$ 321,299
Estimated Prize Liability	2,097,509	1,427,498
Due to Primary Government	17,355	5,945
Transfer Obligations	2,586,944	1,792,596
Deferred Revenue	57,163	171,562
Current Portion Comp. Absences	108,251	77,721
Other Current Liabilities	0	6,500
TOTAL CURRENT LIABILITIES	5,307,048	3,803,121
NONCURRENT LIABILITIES		
MUSL Prize Liability	1,258,965	1,230,442
Accrued Compensated Absences	63,101	78,469
TOTAL NONCURRENT LIABILITIES	1,322,066	1,308,911
TOTAL LIABILITIES	6,629,114	5,112,032
NET ASSETS		
Unrestricted Net Assets	0	0
TOTAL LIABILITIES AND NET ASSETS	$ 6,629,114	$ 5,112,032

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE QUARTERS ENDED DECEMBER 31, 2005 and 2004
(Unaudited)

	Quarter Ended December 31, 2005	Quarter Ended December 31, 2004	Six Months Ended December 31, 2005	Six Months Ended December 31, 2004
OPERATING REVENUES:				
Scratch ticket revenue	$ 3,005,931	$ 2,691,241	$ 5,783,739	$ 5,114,970
Powerball revenue	5,642,053	3,976,908	9,066,692	7,388,681
Montana Cash revenue	1,211,839	904,468	2,085,565	1,739,683
Wild Card revenue	576,333	572,163	1,125,498	1,123,327
Hot Lotto/Rolldown revenue	682,613	585,023	1,277,385	1,379,174
Qwik Tix revenue	89,887	107,710	184,515	233,089
License, permits, and misc	695	3,650	1,245	4,550
Total Operating Revenues	11,209,351	8,841,163	19,524,639	16,983,474
Less Direct Game Costs:				
Scratch ticket prize expense	(1,817,663)	(1,634,307)	(3,524,975)	(3,113,922)
On-line ticket prize expense	(4,004,752)	(3,009,914)	(6,714,090)	(5,879,619)
Retailer commission	(668,926)	(514,333)	(1,173,918)	(975,152)
Cost of tickets sold	(257,240)	(193,742)	(503,774)	(383,012)
Vendor fees	(905,674)	(741,806)	(1,634,362)	(1,431,540)
Net Operating Revenue	3,555,096	2,747,061	5,973,520	5,200,229
OPERATING EXPENSES:				
Advertising	168,432	125,770	261,112	200,301
Advertising Production	19,624	22,825	68,364	109,951
Audit Fees	38,716	14,376	42,097	16,031
Bad Debts Expense	(45)	(67)	(45)	(492)
Communications	21,847	20,956	42,324	41,425
Contractual Services	21,280	20,868	68,233	52,714
Depreciation and Amortization	267,966	267,309	535,930	534,617
Administrative Service Fee	13,486	13,579	26,971	27,159
State Cost Recovery	804	3,318	804	6,635
Multi-State Dues	(27,330)	0	72,333	88,856
Public Relations	4,160	3,108	8,643	6,626
Other	5,015	6,794	16,517	12,277
Personal Services	416,799	369,449	814,195	712,678
Repairs and Maintenance	2,918	4,192	4,201	9,107
Supplies and Materials	21,168	59,685	97,658	78,248
Travel	6,547	5,758	20,218	11,395
Utilities and Rent	28,692	28,159	55,415	54,339
Total Operating Expense	1,010,079	966,079	2,134,970	1,961,867
Operating Income	2,545,017	1,780,982	3,838,550	3,238,362
NONOPERATING REVENUES (EXPENSES)				
Interest earnings	41,927	13,339	63,022	20,431
Gain/Loss on sale of asset	0	(1,725)	0	(1,725)
Total Nonoperating Revenues(Expenses)	41,927	11,614	63,022	18,706
Income Before Operating Transfers	2,586,944	1,792,596	3,901,572	3,257,068
Operating Transfers In (Out) - General Fund	(2,586,944)	(1,792,596)	(3,901,572)	(3,257,068)
CHANGE IN NET ASSETS	0	0	0	0
Total Net Assets, Beginning of Period	0	0	0	0
TOTAL NET ASSETS, END OF PERIOD	0	$ 0	$ 0	$ 0

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET FUND ASSETS
AND RECONCILIATION OF BUDGET AND ACTUAL (BUDGETARY BASIS) TO GAAP BASIS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2005
(Unaudited)

	Budget Fiscal Year July 1, 2005 - June 30, 2006	Actual Six Months Ended December 31, 2005 (Unaudited)	Actual as a Percent of Final Budget (%)
REVENUES:			
Scratch ticket revenue	$ $10,500,000	$ 5,783,739	55.08
Powerball revenue	17,500,000	9,066,692	51.81
Montana Cash revenue	4,400,000	2,085,565	47.40
Wild Card revenue	2,300,000	1,125,498	48.93
Hot Lotto revenue	2,650,000	1,277,385	48.20
Qwik Tix revenue	500,000	184,515	36.90
License, permits, and miscellaneous	2,000	1,245	62.25
Total Revenues	37,852,000	19,524,639	51.58
DIRECT GAME COSTS:			
Prizes - Scratch ticket	6,195,000	3,524,975	56.90
Prizes - Lotto games	13,311,000	6,603,362	49.61
Prizes - Qwik Tix	300,000	110,728	36.91
Retailer commissions	2,222,500	1,173,918	52.82
Ticket cost - scratch games	735,000	503,774	68.54
Ticket cost - vendor fees	3,160,475	1,634,362	51.71
Total Direct Game Costs	25,923,975	13,551,119	52.27
OPERATING EXPENSES:			
Advertising	633,390	261,112	41.22
Advertising Production	111,200	68,364	61.48
Audit Fees	45,000	42,097	93.55
Communications	69,790	42,324	60.64
Contractual Services	177,834	68,233	38.37
Administrative Service Fee	53,281	26,971	50.62
State Cost Recovery	3,143	804	25.58
Multi-State Dues	102,975	72,333	70.24
Public Relations	34,124	8,643	25.33
Other	31,220	16,517	52.91
Personal Services	1,513,170	825,144	54.53
Repairs and Maintenance	22,055	4,201	19.05
Supplies and Materials	203,688	97,658	47.94
Travel	35,186	20,218	57.46
Utilities and Rent	112,600	55,415	49.21
Equipment	45,839	6,859	14.96
Total Operating Expenses	3,194,495	1,616,893	50.61
Operating Income	8,733,530	4,356,627	49.88
NONOPERATING REVENUES (EXPENSES):			
Interest Earnings	0	29,237	
Gain/(Loss) on Sale on Asset		0	
NET INCOME (BUDGETARY BASIS)	$ 8,733,530	$ 4,385,864	50.22
RECONCILIATION OF BUDGETARY/GAAP BASIS:			
1. Capitalized equipment purchases	45,839	6,859	14.96
2. Adjustment for compensated absences		10,949	
3. Adjustment for depreciation expense	(790,441)	(535,930)	67.80
4. Bad Debts		45	
5. MUSL interest earnings	20,000	33,785	168.93
Total Reconciling Items	(724,602)	(484,292)	
NET INCOME (GAAP BASIS)	$ 8,008,928	$ 3,901,572	48.72

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
ANALYSIS OF REVENUES AND EXPENSES BY PRODUCT
FOR THE SIX MONTHS ENDED DECEMBER 31, 2005
(UNAUDITED)

	SCRATCH	POWERBALL	MONTANA CASH	WILD CARD	HOT LOTTO	QWIK TIX	ADMIN
REVENUES:	$ 5,783,739	$ 9,066,692	$ 2,085,565	$ 1,125,498	$ 1,277,385	$ 184,515	$ 1,245
DIRECT GAME COSTS:							
Prize Expense	3,524,975	4,398,697	1,001,074	592,640	610,951	110,726	0
Retailer Commissions	486,520	453,591	104,312	56,304	63,896	9,296	0
Cost of Tickets Sold	503,774	0	0	0	0	0	0
Vendor Fees	482,865	760,032	174,741	94,307	107,010	15,406	0
NET OPERATING REVENUE	785,605	3,454,372	805,438	382,247	495,528	49,085	1,245
OPERATING EXPENSES:							
Advertising	63,488	115,140	26,646	26,646	26,645	858	1,688
Advertising Production	7,973	45,457	4,979	4,977	4,978	0	0
Audit Fees	0	0	0	0	0	0	42,097
Bad Debts	0	0	0	0	0	0	(45)
Communications	23,188	700	700	700	700	700	15,636
Contractual Services	1,700	8,958	461	462	462	404	55,786
Depreciation and Amortization	152,015	250,113	58,005	31,382	35,539	5,531	3,346
Administrative Service Fee	6,371	2,843	2,438	1,672	1,659	1,416	10,572
State Cost Recovery	0	0	0	0	0	0	804
Multi-State Dues	0	4,340	0	12,562	4,312	0	51,119
Public Relations	791	1,399	1,399	1,399	1,399	1,399	857
Other	267	2	2	2	3	0	16,241
Personal Services	278,179	91,927	71,150	43,480	42,992	37,258	249,207
Repairs and Maintenance	13	0	0	0	0	0	4,188
Supplies and Materials	30,712	5,645	5,734	5,644	5,644	5,257	39,021
Travel	382	112	112	112	112	0	19,388
Utilities and Rent	0	0	0	0	0	0	55,415
TOTAL OPERATING EXPENSES	565,079	526,636	171,626	129,038	124,445	52,823	565,320
OPERATING INCOME	220,526	2,927,736	633,812	253,209	371,083	(3,738)	(564,075)
NONOPERATING REVENUES (EXPENSES)							
Interest Earnings	0	0	0	0	0	0	63,022
Gain(Loss) on Sale of Asset							0
TOTAL NONOPERATING REVENUES ENSES)	0	0	0	0	0	0	63,022
NET INCOME BY P	$ 220,526	$ 2,927,736	$ 633,812	$ 253,209	$ 371,083	(3,738)	$ (501,053)
PROFIT AS A % OF REVENUE	3.81%	32.29%	30.39%	22.50%	29.05%	-2.03%	N/A

NOTE: THIS IS ONLY TWO QUARTER'S ACTIVITY AND THEREFORE SHOULD NOT BE INTERPRETED TO SHOW HOW OUR PRODUCTS HAVE PERFORMED IN PAST YEARS OR WILL PERFORM IN THE FUTURE.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and countries, and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting agency.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Revenue Recognition. Lottery scratch ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Ticket sales for lotto games, Powerball, Wild Card, Montana Cash, and Hot Lotto are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing. Qwik Tix revenue is recognized at the time of sale by the retailers.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes scratch tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the quarter ended December 31, 2005, promotional credits resulted in a revenue reduction of approximately $16,876 and an advertising expense reclassification of approximately $12,695. For the six months ended December 31, 2005, promotional credits resulted in a revenue reduction of approximately $51,496 and a prize expense reclassification of approximately $38,046

Prizes. Expenses for scratch prizes are recorded based on the predetermined prize structure for each game. Expenses for lotto and Qwik Tix prizes are recorded based on the predetermined prize structure for each individual game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the lotto games must be claimed within six months after the appropriate draw date. Prizes for scratch games must be claimed within six months of the announced end of each game. Qwik Tix prizes must be claimed within six months of the sale date. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all games is represented in the table below.

	Quarter Ended 12/31/05	Quarter Ended 12/31/04	Year To Date 12/31/05	Year To Date 12/31/04
Lotto & Qwik Tix	$134,813	$124,139	$314,839	$249,353
Scratch	47,660	24,525	73,123	41,230
TOTALS	$182,473	$148,664	$387,962	$290,583

2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	December 31,	
	2005	2004
Short-term investment pool	$2,258,166	$205,261
Cash on deposit with State Treasurer	531,685	9,631
Cash in revolving deposit account	10,000	10,000
Petty Cash	150	150
TOTALS	$2,800,001	$225,042

Reference to the State of Montana's Comprehensive Annual Financial Report would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was $31,334 at December 31, 2005 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include $1,467,271, representing amounts due the Lottery for tickets purchased by retailers. An allowance for doubtful accounts is reported as net of receivables and is based on historical perspective. As of December 31, 2005 the allowance is zero. An allowance for ticket returns is also included in the receivables amount. This allowance represents a reduction in receivables at December 31, 2005, for estimated ticket returns. This is an estimate based on returns received to date, as well as, an estimate of tickets unsold by retailers for games that have a public sale end date prior to January 1, 2006. The

allowance for ticket returns is $149,326 at December 31, 2005. The return of vendor fees related to the allowance for returns is $12,417.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes scratch tickets valued at $735,139 stored in the warehouse, at retailers prior to being activated by the retailer and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At quarter end, supplies inventories totaled $88,133. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets consist of the following:

	December 31,	
	2005	2004
Prepaid Expenses	15,450	16,505
Employee Advances	1,750	2,400
TOTALS	$17,200	$18,905

Transfer Obligations. The account "Transfer Obligations" is $2,586,944 payable to the General Fund at December 31, 2005.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

Balance June 30, 2005	Net Leave Earned/(Used)	Balance December 31, 2005
$160,403	$10,949	$171,352

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on scratch, Qwik Tix and lotto tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of scratch tickets activated by the retailers and the face value of Qwik Tix and lotto tickets sold. In addition retailers can earn bonus commissions on tickets sold based on incremental sales of scratch tickets. For the quarter and six months ended December 31, 2005 retailers earned bonus commissions of $107,573 and $195,058 respectively. For the quarter

and six months ended December 31, 2005 total commissions were $668,926 and $1,173,918 respectively.

3. MARKETING PRODUCTION EXPENSES

The Lottery has contracted with several vendors to provide marketing related services and materials. These services include media placement, creative design and layout, and media production. Those services and materials not included in the Advertising and Advertising Production expense categories are printing and ticket dispensers. The cost of these services and materials, included in Operating Expenses as Contracted Services and Supplies and Materials, are detailed below for the six months ended December 31, 2005:

Printing	$20,591
Ticket Dispensers	15,629
	$36,220

4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services and supplies and materials from other state agencies. These services and materials are detailed below for the six months ended December 31, 2005:

Insurance	$ 9,106
Warrant Writing Services	444
Payroll Services	525
Audit Fees	26,649
Computer Fees	13,520
Printing	1,473
State Accounting System Support	5,570
Supplies and Materials	3,620
Mail Processing Fees	3,176
Telecommunications	8,523
Vehicle Rental Fees	821
Administrative Service Fees	26,971
SWCAP and SFCAP	804
Other	2,180
TOTAL	$103,382

5. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game less

unclaimed prizes. For the quarter ended December 31, 2005, the prize expense of $5,822,415 is 51.95% of net Lottery ticket revenue of $11,208,656. For the six months ended December 31, 2005, the prize expense of $10,239,065 is 52.45% of net Lottery ticket revenue of $19,523,394.

6. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund." For the quarter ended December 31, 2005, the net revenue payable to the State General Fund totaled $2,586,944.

7. MULTI-STATE LOTTERY JOINT VENTURE

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, and Hot Lotto are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Receivable with a balance of $1,320,079 as of December 31, 2005 is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). The balance of these reserve accounts is as follows:

Powerball Prize Reserve Account	$589,186
Powerball Unreserved Account	61,115
Powerball Set Prize Reserve Account	186,355
Wild Card Reserve Account	415,074
Hot Lotto Set Prize Reserve Account	68,349
TOTAL	$1,320,079

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid. Interest earned on the Lottery's share of the fund, represented by the Unreserved Account, would be returned to the Lottery upon

leaving MUSL. The amounts in the Unreserved Account may be used at the Board's discretion.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball Game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than making a lump sum payment. Payments made to this fund are considered a portion of prize expense associated with the game.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana, South Dakota, and North Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

8. GAMES

Currently, the Montana Lottery games are scratch ticket games, four lotto games referred to as Powerball, Montana Ca$h, Wild Card, and Hot Lotto and four instant play/instant win games referred to as Qwik Tix.

Scratch ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately $15 million. A player must match all 6 numbers to win the jackpot; players win prizes ranging from $3 to $200,000 for matching less than all 6 numbers. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. In March 2001, the Lottery added

Power Play to the Powerball game. For an additional bet, the Power Play option provides non-jackpot winners the chance to multiply their prize amount by a factor of two through five.

The Montana Ca$h game allows players the chance to win a minimum pari-mutuel jackpot of $20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins $5 and 4 of 5 wins $200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of $100,000. Players select 5 numbers from a field of 31 plus one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from $1 to $5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of $1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from $2 to $10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Qwik Tix is a product line introduced by the Lottery in February 2004. There are four games, each with its own play style and prize structure. The four games are Lucky Numbers, a number match game; Hot Tac Toe, a tic tac toe grid; Jacks or Better, a poker game; and Montana Match, a match three symbols game. The Qwik Tix tickets are printed at the lotto terminal at the time of sale and can be redeemed immediately, with the maximum prize being $500. Each ticket costs $2 and consists of either two plays of a single Qwik Tix game or one play of a Qwik Tix game and one play of a related lotto game. The lotto games sold in this manner are exactly the same as lotto tickets sold separately and cannot be redeemed until the appropriate drawing.

9. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Scratch Tickets. On June 27, 2001 the Montana Lottery Commission approved the award of a one-year contract with Oberthur Gaming Technologies Corp. (Oberthur) for the provision of scratch tickets; the resulting contract was signed on August 8, 2001. The contract is for one year with the option for six additional one-year renewals. The contract contains specifications regarding ticket design, printing,

game ownership, inspection, and prize structure.

Oberthur, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of $7,500,000. The Lottery may terminate this contract by providing proper notification to Oberthur.

On-line Services. On August 18, 1998, the Lottery signed a seven-year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning March 28, 1999. The contract provides for payments to be made for the purchase of an on-line gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation $5,025,311 for the system on April 26, 1999. Payment under the contract is also based on 8.35% of weekly Lottery sales. This contract expires on March 30, 2006.

On October 11, 2005, the Lottery signed a seven-year contract with Intralot, Inc. of Duluth, GA to provide an on-line gaming system and the associated services beginning March 31, 2006. The contract requires Intralot to provide new terminals to all retailers with the associated software and communications. Payment under the contract is based on 5.8% of net weekly Lottery sales. The contract provides for three one-year extensions, if agreeable by both parties.

10. CONTINGENT LIABILITIES - PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totaling $5,000,000. The Lottery made the initial payments to the winners in the amount of $253,088 and on September 26, 1988 the Montana Lottery awarded annuities in the amount of $2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of December 31, 2005 the contingent liability for future prize payments funded through the purchase of annuities was $280,000.

11. LOTTO*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On January 13, 1990 the Montana Lottery awarded its first Lotto*America jackpot prize totaling $1,740,000. The first annual payment of $87,000 was made on February 1, 1990. On May 9, 1990 the Lottery awarded a second Lotto*America jackpot prize of $3,000,000. The first annual payment of $150,000 was made on May 23, 1990. A third jackpot prize was awarded on February 2, 1991 for $7,360,000. The first annual payment of $368,000 was made February 15, 1991.

On November 23, 1991 a fourth jackpot prize was awarded totaling $46,967,738.57. The first annual payment of $2,355,738.57 was made December 12, 1991. On April 11, 1992 a fifth jackpot prize was won totaling $2,000,000. The first annual payment of $100,000 was made on April 27, 1992.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling $700,565. The first annual payment of $35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling $31,401,655.99. The first payment of $1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling $11,000,000. The first annual payment of $550,000 was awarded on April 18, 1997.

As of December 31, 2005 the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Lotto*America winners was $15,128,739. The combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners was $20,460,210.

On March 27, 1999 the Montana Lottery had a Powerball jackpot winner. The prize was $35.1 million ($19.35 million cash option). The winner chose the cash option and was paid a lump sum in June 1999.

12. LEASES

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a noncancelable lease agreement that is effective March 2002 through February 2007. The monthly lease payments through February 2006 are $7,476 and will increase 1.5% per year.

13. INVESTMENT RISK DISCLOSURES

Effective June 30, 2005, the State of Montana implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40, *Deposit and Investment Risk Disclosures*. The Lottery participates in two investment pools: the Multi-State Lottery Association (MUSL) reserve accounts and the State of Montana's Short Term Investment Pool (STIP). There are four types of risk that must be disclosed. These risks are defined below, followed by their applicability to each of the investment pools.

Credit risk is defined as the risk that an issuer of an investment will not fulfill its obligation, i.e., not make timely principal and interest payments.

Custodial credit risk is the risk that the Lottery would not be able to recover the value of the investment or collateral securities that are in the possession of an outside party in the event of the failure of that party.

Concentration of credit is the risk of loss attributed to the magnitude of a government's investment in a single issuer.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

Multi-State Lottery Association The MUSL investment policy for prize reserve and unreserved funds states that permitted investments "include direct obligations of the United States government, perfected repurchase agreements, and obligations issued or guaranteed as to payment of principal and interest by agencies or instrumentalities of the United States government, and mutual funds of approved investments". Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk nor concentration of credit risk per GASB Statement No. 40.

The securities are held in trust for MUSL by Mellon Trust. This large diversified institution was chosen to minimize custodial risk. It has several national offices, with the Everett, Massachusetts office handling the MUSL account. Interest rate risk is minimized by requiring that the average portfolio maturity be no more than 1.33 years and that the maximum maturity for any one security cannot exceed five years.

Short-term Investment Pool All short-term funds are held in the State's Short Term Investment Pool (STIP) administered by the Board of Investments (BOI). A summarized description of their disclosure follows and full details may be obtained by contacting the Montana Board of Investments, 2401 Colonial Drive, PO Box 200126, Helena, MT 59620-0126.

For STIP securities, BOI's policy to manage credit risk requires securities have the highest investment grade rating in the short-term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSROs include Standard and Poors, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch.

Per the BOI, all STIP securities are registered in the nominee name for the Montana Board of Investments and held in the possession of the Board's custodial bank. The STIP investment policy does not specifically address concentration of credit risk. However, as of June 30, 2005 there were no single issuer investments that exceeded 5% of the STIP portfolio. Per GASB Statement No. 40, interest rate disclosures are not required for STIP since STIP is a 2a-7-like pool.

Alternative accessible formats of this document will be provided upon request.